Title: Amendments to Pension Schemes Bill (private sector defined benefit transfers) **IA No:** RPC14-HMT-2212 **Lead department or agency:** HM Treasury **Other departments or agencies:** Department for Work and Pensions	Impact Assessment (IA)
	Date: 19 September 2014
	Stage: Final
	Source of intervention: Domestic
	Type of measure: Primary legislation
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Summary: Intervention and Options

RPC Opinion: Green

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
-£4.15m	-£18.43m	£1.69m	Yes	IN

What is the problem under consideration? Why is government intervention necessary?

The additional flexibility for defined contribution (DC) pensions from April 2015 has the potential to increase the attractiveness of transferring from defined benefit (DB) to DC pension schemes. This introduces two risks, namely that DB members choose to transfer out of their DB scheme when it is not in their best financial interest; and that a large volume of transfers could destabilise DB schemes, through crystallising their liabilities.

What are the policy objectives and the intended effects?

The overarching objective is to limit and mitigate the risks associated with any increased withdrawals from private sector DB schemes. This includes ensuring that members of DB schemes understand the financial implications of transferring to a DC scheme, helping to ensure that individuals are better informed of the choices available to them. This also includes ensuring that pension fund trustees are fully aware of the powers available to them over the terms of DB transfers, to help mitigate risks to DB pension schemes from an increase in demands for transfers.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Amendments to the Pension Schemes Bill constitute the final stage of policy development for DB to DC transfers, which began with announcements at Budget 2014. During the subsequent consultation period HM Treasury has considered a range of options: (0) banning the ability of members of DB schemes to transfer to a DC scheme; (1) no change – allowing DB to DC transfers with current safeguards; and (2) allowing DB to DC transfers with additional safeguards. The preferred option is to continue to allow transfers along with the introduction of additional safeguards to protect scheme members and schemes themselves. This strikes an appropriate balance by not limiting the existing freedom of individuals to transfer between DB and DC schemes, but introducing proportionate measures to help mitigate the associated, limited, risks from DB transfers. The additional safeguards help to ensure individuals are well informed in their available choices and schemes are well informed of their existing powers to manage transfers, while not placing an unduly large burden on businesses to administer such safeguards.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** Post April 2015

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: .... Date: 19/09/2014

Summary: Analysis & Evidence

Policy Option 1

Description: The Government does not implement the measures amending the Pension Schemes Bill to provide for additional safeguards for individuals transferring from private defined benefit to defined contribution pension schemes. This is the baseline against which the impact of Policy Option 2 is measured.

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2014	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	**High:** 0	**Best Estimate:** 0

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0	0	0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised costs by 'main affected groups'

This is zero, as the impact of not introducing additional safeguards will impose no additional costs incremental to the current situation.

Other key non-monetised costs by 'main affected groups'

Zero, as above.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	0	0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

This is zero, as the impact of not introducing additional safeguards will result in no additional benefits incremental to the current situation.

Other key non-monetised benefits by 'main affected groups'

Zero, as above.

Key assumptions/sensitivities/risks **Discount rate (%)**

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: n.a.	**Benefits:** n.a.	**Net:** n.a.	n.a.	n.a.

Summary: Analysis & Evidence Policy Option 2

Description: Trustees of private sector DB schemes are required to verify that individuals have taken professional financial advice, from an advisor authorised by the FCA and independent of the DB scheme, before transferring to a DC scheme; and the Government will work with the Regulator to issue new guidance to pension fund trustees on the existing powers available to them over the terms and timing of transfers.

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2014	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -£80.98m	**High:** £71.08m	**Best Estimate:** -£4.15m

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£0	1	£0.22m	**£1.91m**
High	£0.33m		£9.37m	**£80.98m**
Best Estimate	£0.29m		£3.84m	**£33.33m**

Description and scale of key monetised costs by 'main affected groups'

The main impacted groups would be employers operating DB schemes and pension scheme members. We estimate that total costs in our central scenario are **£3.85m** per annum (current prices), of which **£2.11m** falls on businesses. This is made up of two costs for employers or schemes:

(1) An ongoing administrative burden of verifying whether scheme members have received professional financial advice before initiating a transfer, where it is requested by the employee. Our central estimate for the ongoing compliance costs, based on analysis of pension schemes' administrator wages and time taken to verify advice, is **£0.44m** per annum.

(2) The cost of providing professional financial advice when running transfer exercises or when a member transfers to a DC scheme operated by the same employer (intra-employer transfer). We have estimated the average cost of professional financial advice at £156 per hour, and that the average advice session will take around 7.5 hours, resulting in a unit cost of provision of financial advice of £1,170 per member transferring.

Employers are already expected to pay for financial advice when they undertake incentivised transfer exercises in accordance with an industry Code of Conduct. There is little evidence that firms are avoiding this; we assume in the central case provision of advice currently at 90% of transfers. This implies our central estimate of the incremental cost from making advice a statutory requirement for transfer exercises is **£0.65m** per annum.

The number of intra-employer transfers between schemes is estimated to be 8,676 in 2015/16 (and beyond). Current anecdotal evidence from industry suggests that the majority of DC schemes already require new members to the scheme to have received financial advice, as such we assume a central estimate that 90% of transfers will have received financial advice. Based on this our central estimate is that the incremental costs would be **£1.02m** per annum.

There are anticipated to be minor familiarisation costs occurred in reading the new information around compliance, after making verification of advice a statutory requirement, and also from familiarisation with the new guidance that will be issued over pension fund trustees' existing powers over the terms and timing of transfers. This is estimated at **£0.29m** for scheme administrators.

There will also be a cost for pension scheme members, who will be required to pay for financial advice when initiating a transfer from a DB to DC scheme. Many people would already take financial advice on leaving a DB pension scheme and a proportion will no longer have to pay for it as they are transferring from DB-DC within the same pension scheme. We estimate that the additional cost to individuals would be **£1.73m** per annum.

Other key non-monetised costs by 'main affected groups'
Scheme members and administrators may need to spend time locating and verifying the quality of advice provided by professional financial advisers. However, from scheme administrators' perspective, many already undertake tendering for independent financial advice, where it is currently required in relation to DB to DC transfers, and it is reasonable to assume that this cost will not increase significantly following the wider reforms and introduction of additional safeguards for DB transfers.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	0	£0	**£0**
High	0		£8.48m	**£72.99m**
Best Estimate	0		£3.39m	**£29.18m**

Description and scale of key monetised benefits by 'main affected groups'

Professional financial advisers will be positively impacted to the same extent that those paying for financial advice are negatively affected; this is an indirect effect as a result of the regulation, and is therefore not included in the estimated annual net cost to business. The benefits to advisors will amount to the additional number of people that will require advice as a result of the new statutory requirement (2,900 p.a.) and the estimated value of advice (£1,170 as above). This generates benefits to advisers of **£3.39m** per annum.

Other key non-monetised benefits by 'main affected groups'

There will be benefits to individuals, in that those who receive financial advice who would not have done previously will be better informed about the choices available to them and implications of transferring from a DB to DC scheme. The financial benefit of this is difficult to estimate and quantify as it is dependent on individual financial circumstances and preferences.

There will also be benefits for pension schemes themselves. The requirement for financial advice will limit the risk of an increase in transfers that would be sufficient to destabilise schemes. The issuance of new guidance over fund trustees' powers over the terms and timing of transfers will help to ensure trustees are better informed of those powers available to them.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

The key assumption is around the number of individuals who will decide to transfer from a DB pension take advantage of the new freedoms in DC pensions. We have estimated that 7.6% of DB scheme members retiring each year will choose to transfer to a DC scheme as a result of the wider flexibility in DC pensions. This result is derived from an assumption that average transfer values offered to DB members are 80% of the Cash Equivalent Transfer Value (CETV) from a DB to DC scheme. In addition, there is no 'stock' of people waiting to transfer out of DB schemes, and that individuals do not transfer before the point of crystallising their pension entitlement.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: £1.69m	**Benefits:** £0.00m	**Net: -**£1.69m	YES	IN

Evidence Base

Section 1: Background

1. Budget 2014 announced changes to introduce greater freedom and choice in pensions. From April 2015, individuals will be able to withdraw savings from their defined contribution (DC) pensions as they wish, subject to their marginal rate of income tax. Under the previous system, only those individuals with small or very large amounts of DC pension wealth were able to access them flexibly, with the majority of individuals effectively required to purchase an annuity or face a 55% tax rate on withdrawals.
2. In contrast to members with DC savings, where there is a pension 'pot', members of defined benefit (DB) schemes build up an entitlement to a level of annual pension based on their membership history (typically a function of years of service and the schemes' 'accrual rate'). Currently, individuals with DB pension entitlement can request a transfer to a DC arrangement. The amount that an individual can transfer is known as a 'cash equivalent transfer value' (CETV), which represents the capital cost of meeting the future pension liability. This is a complex calculation which takes into account a number of factors including the scheme benefits, market conditions, mortality assumptions and the financial position of the scheme[1]. Currently only about 40,000 people per year choose to exercise this right, of which 20,000 are members of private sector schemes.[2]
3. Alongside the announcement at Budget 2014 of the Government's intention to change the tax rules to allow for greater freedom and choice in DC pensions, the Government published a consultation on how best to implement the reforms.[2] The consultation sought views from interested parties on a range of issues in relation to the Budget announcements, including the design of the new tax framework to provide for greater freedom and choice, and the design of the Government's guarantee to offer individuals retiring with DC pensions guidance, which would be free at the point of delivery, on their range of available choices.
4. The consultation also sought views on the issues and options considered in this IA in relation to transfers from DB to DC schemes, in particular whether the Government should continue to allow individuals to transfer from private sector DB schemes to DC schemes.[4] As set out in the consultation document, while the Government's wish is to extend flexibility to as many individuals as possible, the role that investments by DB pension schemes play in the wider economy and financial markets meant the Government necessarily needed to proceed with caution.
5. The additional flexibility for those in DC pensions also has implications for members of public service DB pension schemes. The majority of these schemes are unfunded, and as transfers

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[1] Financial Conduct Authority definition 2
OPPS, Ref: 003033 - http://www.ons.gov.uk/ons/about-ons/business-transparency/freedom-of-information/what-can-i-request/published-ad-hocdata/econ/july-2014/index.html. Figures are rounded to the nearest 10,000; there is a lack of clarity around the exact transfers which are included within this survey. However, the 20,000 figure for private DB transfers is in keeping with anecdotal evidence and past trends, and, given the lack of available data, it is the most robust figure we can use for this IA.

[2] *Freedom and choice in pensions*, HM Treasury, March 2014 4
In this document the term DB scheme relates to a pension scheme where some or all of the members benefits have an associated income in retirement promise. The term DC scheme relates to a pension scheme where the member will accumulate a cash sum with which they can opt to select a retirement income. Some DB scheme members will also have DC savings within the same scheme which they will be able to access flexibly under the proposed changes.

from these schemes in order to access pension savings flexibly represents a net cost to the exchequer (1% of retiring members transferring and drawing down their pension flexibly equating to roughly £200m cost per annum) the Government took the decision to ban transfers from unfunded public service schemes to DC schemes.

6. The Government undertook an extensive consultation following the initial announcements at Budget 2014. The Government received 372 responses from individuals and organisations, and on 21 July set out its response to the consultation, outlining the further policy decisions that had been taken to deliver its intentions for greater freedom and choice in pensions.[3] The response to the consultation outlined the decisions around the tax system to provide for greater flexibility in accessing DC pensions, along with details of the corresponding guarantee to free and impartial guidance on an individual's choices at retirement.

7. The response to the consultation also confirmed that the Government would continue to allow transfers from private sector DB to DC pension schemes, subject to two additional safeguards that are assessed in the rest of this IA. This decision accorded with the significant majority of respondents to the consultation, including the Association of British Insurers (ABI),
Confederation of British Industry (CBI) and National Association of Pension Funds (NAPF) that argued that the current right to transfer should remain, but that additional safeguards should be introduced to limit risks to individuals and to pension schemes. In relation to public service schemes, the Government confirmed that transfers from funded public service schemes would continue to be permitted, and similar safeguards to those for private sector transfers will also be introduced, where appropriate.

8. The Pension Schemes Bill has been introduced to Parliament, which would provide for reforms to encourage new arrangements for pension savings that offer different levels of certainty, or that involve different ways of sharing or pooling risk. The Government is introducing amendments to the Pension Schemes Bill to provide for elements of HM Treasury's freedom and choice in pensions reforms, in particular in relation to the introduction of safeguards for private sector DB transfers (that are analysed in this IA), along with a ban on unfunded public service DB to DC transfers and the guidance guarantee.

9. The rest of this IA is structured as follows: section 2 considers the policy problem under consideration; section 3 outlines the options considered; section 4 analyses the costs and benefits of the preferred policy option; section 5 considers the wider impacts; section 6 outlines the implementation plan for the preferred policy option; and section 7 details the other legislative amendments as a result of pensions flexibilities and to implement the policy option for DB to DC transfers. Details of the assumptions underlying the cost-benefit analysis are in Annex A; while Annex B includes further detail of the analysis underpinning assumptions of transfer values offered and resulting take up of DB transfers.

Scope of this IA

Measures in scope of this IA

10. This IA covers amendments to the Pension Schemes Bill that take forward the elements of HM Treasury's pensions flexibility policies in relation to private sector DB to DC transfers. The ability to transfer from a private sector DB to DC scheme is a continuation of the previous status quo. As such, this IA covers amendments that provide for the policy changes

[3] *Freedom and choice in pensions: government response to the consultation*, HM Treasury, July 2014

with a regulatory impact, namely the introduction of two additional safeguards that go alongside the continuing ability of individuals to transfer from a DB to DC pension scheme:

1) a statutory requirement on transferring defined benefit schemes for all individuals considering transferring out to take professional financial advice; and

2) the issuance of new guidance from the Pensions Regulator to pension scheme trustees on the powers available to them over the terms of any DB to DC transfers.

11. Although the second of these – new guidance to trustees – will not in practice require amendments to the Pension Schemes Bill to allow for it, as it simply signposts existing powers available, it is considered in this IA in the context of potential familiarisation costs to trustees, alongside wider familiarisation costs from the new statutory requirement for financial advice.

12. This IA also covers legislative amendments required as a consequence of the pension flexibilities announced in Budget 2014. These enable the policy to be implemented as set out in the response to the consultation but are not anticipated to result in significant direct costs or benefits. These are explained in Section 6.

Measures out of scope of this IA

13. This IA does not cover changes to the tax rules that provide for the wider flexibility for those with DC pensions, which are being legislated for in the Taxation of Pensions Bill. HMRC will publish a Tax Information and Impact Note (TIIN) alongside the introduction of this Bill to Parliament.

14. This IA also does not cover amendments to provide for a ban on transfers from public service unfunded DB schemes to DC schemes, as the only bodies affected by this measure are public sector bodies – namely public service pension schemes and their administrators.

15. The Government's response to the freedom and choice in pensions consultation indicated that, in the case of transfers from funded public service schemes, the Government would give consideration to safeguards akin to those for transfers from private sector schemes. Subject to confirmation of the detail of any further safeguards for transfers from funded public service schemes, this will be reflected if necessary in subsequent updates to this IA.

Section 2: Problem under consideration

16. The level of security provided by defined benefit pension saving, including a guaranteed level of income and inflation protection, will mean that they will continue to represent the best option for the majority of DB pension members. However, the attractiveness of moving from a DB to a DC scheme has the potential to increase as a result of the reforms to offer greater flexibility in accessing DC pensions. This introduces three main risks:

a) Some DB scheme members may transfer without being fully informed of the implications of transferring, including whether doing so would be in their best financial interests;

b) An increase in the volume of transfers, in crystallising schemes' liabilities, could destabilise some DB schemes;

c) Similarly, an increase in the volume of withdrawals has implications for markets for asset classes dominated by defined benefit schemes, particularly demand for long dated and index linked government and corporate debt, which could in turn impact the wider economy.

Risks to individuals

17. DB pension schemes provide a level of security, including a guaranteed income in retirement and protection against inflation and investment risks, that DC schemes do not. For the majority of individuals, remaining in a DB scheme will remain in their best interests, even following the introduction of greater flexibility for those with DC schemes. However, pensions are complex financial products, and it is challenging for individuals to have complete information about their individual circumstances and implications of different options, including transferring out of a DB scheme. The greater flexibility afforded to DC schemes risks increasing the willingness of individuals to transfer from a DB scheme to take advantage of flexibility, without a sufficiently clear understanding of the consequences of such action.

Risks to pension schemes

18. DB pension schemes' promises to their individual members around the amount of their pension entitlement constitute their liabilities. While a DB pension in itself does not have a 'pot' sitting behind it, into which an individual or employer makes contributions, a DB pension scheme can either be funded or unfunded. In funded schemes, liabilities are matched by corresponding assets (from current member and employer contributions) that are invested to generate a return to pay out current and future liabilities. In unfunded schemes, no such corresponding assets exist, with liabilities paid out on a pay-as-you-go basis. However, in practice most schemes are not fully funded, instead with a level of assets that does not fully meet their total liabilities.

19. Data from the Pensions Regulator[4] shows that UK private sector DB schemes had an aggregate funding gap of £210.8 billion as of March 2013, or an average of £33.8 million per scheme (although there is most likely large variation across schemes according to their size and maturity of liabilities). As such, DB schemes will in general manage their liabilities and assets in the way that other investment funds would. The risk to schemes from an increase in demand for transfers is that a large volume of transfers would crystallise a scheme's liabilities, which depending on its funding position and asset structure it may not be able to meet.

Risks for financial markets

20. In total, private sector defined benefit schemes hold around £1.1 trillion of assets, which they invest with the objective of generating a return to meet their obligation to scheme members. Schemes tend to invest their funds across a range of asset classes – these investments include equities, government bonds, corporate bonds, property and infrastructure. The proportion of their portfolio held in equities (35%) and government and index-linked securities (45%) remains high. While their holdings of corporate bonds are a lower proportion of their portfolio, the absolute level is high, at around £200 billion.[7]

21. The investment strategies of defined benefit schemes have been evolving in recent years. Equity allocations have fallen from 61% to 35% of funds' assets between 2006 and

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[4] The Pensions Regulator, Purple book 2013. Figure is for PPF eligible schemes, which excludes the larger public sector DB schemes. [7] HMT analysis in 'Freedom and choice in pensions', HM Treasury, March 2014 [8] Ibid.

2013. During the same period, funds' holdings of government and index linked securities (typically inflation linked government bonds), and corporate bonds increased from 28% of their overall assets to 45%.[8]

22. As defined benefit schemes require a predictable income stream to fund their pensions in payment or entering payment, more mature schemes tend to hold more fixed income assets. Long-dated government bonds and highly-rated corporate bonds are typically favoured by defined benefit pension schemes. Inflation linked bonds are a particularly good match for the index-linked liabilities of defined benefit pension schemes. As such, UK defined benefit pension funds play an important role in the market for inflation linked UK government debt.

23. Average asset allocation data suggests that defined benefit schemes hold around £90 billion of conventional gilts and as much as £200 billion of index-linked gilts, much of them likely to have longer-maturities.[5] These holdings are particularly significant for index-linked gilts, potentially accounting for over half of the total market.

24. Defined benefit schemes' holdings of corporate bonds are also significant; it is estimated that schemes currently hold around £200 billion of corporate bonds[6], the majority issued by domestic corporations, but also some foreign corporate bonds in sterling and other denominations.[7] The outstanding value of the UK Sterling corporate bond market is estimated to be around £335 billion.[12]

Impact of behavioural change on financial markets and the economy

25. Behavioural change by defined benefit members switching out of their scheme would impact on the overall *stock* of investments held by defined benefit schemes. If members of defined benefit schemes were to continue to be permitted to transfer to defined contribution schemes without the safeguards of requiring members to take financial advice (and re-issuing guidance to trustees on their existing powers), then the stock of assets currently held by defined benefit schemes could potentially be affected. For example, if a significant number of members were to transfer out of these schemes then the profile of scheme liabilities would shorten and the requirement for index-linked hedging may be reduced. That might affect the demand for long dated and index-linked government and corporate debt in particular. The cash requirements of schemes would also change, which may alter their investment strategies.

26. Given that the stock of defined benefit liabilities and assets exceeds £1.1 trillion, relatively small changes to this stock could have a significant impact on financial markets. In turn this could impact on the wider economy, particularly through the gilts, corporate credit and equities markets.

Policy objectives

27. As set out in the 'freedom and choice in pensions' consultation document, the Government's overriding objective in the reforms to the way individuals are able to access

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[5] The Pensions Regulator, Purple book 2013. Figure is for PPF eligible schemes, which excludes the larger public sector DB schemes.

[6] Ibid.

[7] Mercer, European Asset Allocation Survey

2013 [12] Bank of America/Merrill Lynch Global

Research

their DC pension is to enable greater flexibility, and put choice back in the hands of the individual. With regard to those in DB schemes, the Government's starting point is that it wishes for as many people as possible to be eligible for greater flexibility in how they access their pension. However, the consultation document also stated that the Government would not proceed with continuing to allow private sector DB to DC transfers without sufficient assurance that the wider risks to the economy and financial markets were manageable. As such, its starting point was that transfers from private sector DB to DC schemes would be banned.

28. In particular, the specific objectives with regard to DB schemes is to limit and mitigate the risks outlined above with increased withdrawals from DB schemes, which breaks down into the three channels outlined above – risks to individuals, to pension schemes and to wider financial markets and the economy. As explained in the section below, the Government's policy decision to continue to allow DB to DC transfers was on the basis of its assessment that the overall impact on the DB asset base, and therefore implications for financial markets and the wider economy, is likely to be limited if private sector DB to DC transfers continue to be allowed. Therefore, once that decision had been made, consideration of the form and nature of any additional safeguards alongside the continuing right to transfer, were taken with respect to limiting the risks to individuals and to pension schemes.

Section 3: Policy options considered

Option (0): ban transfers from private sector DB schemes

29. As outlined above, the Government's starting point was that it would ban transfers from private sector DB schemes. The Government undertook detailed engagement with stakeholders during the consultation period to develop its analysis of the potential impact of continuing to allow DB to DC transfers, including engaging pro-actively with key fixed income market participants to seek views on the impact on investment strategies and wider financial markets.

30. Over 85% of respondents to the consultation were against banning transfers from private sector DB schemes. This included the CBI, ABI, NAPF, along with many insurance companies and employer pension funds. Exceptions included a number of trade unions who were concerned that members might transfer out of pension schemes against their best interests.

31. Respondents that opposed banning transfers highlighted that this measure would go against the wider policy rationale of promoting greater freedom and choice in the way individuals are able to access their pension savings. In terms of the specifics of how the wider policy for DC schemes could affect DB transfers, and thus the case for banning such transfers, a number of themes emerged from the consultation, which are explored in more detail in the section below:

a) transferring out of a DB pension is unlikely to be in most individuals' best interests, and although in some cases a transfer may be an appropriate option, the numbers of individuals transferring out is likely to be low;
b) the asset base in financial markets that would be impacted by such transfers is likely to be an extremely small proportion of the overall asset base held by DB pension schemes (currently estimated at £1.1 trillion);

c) any wider impact on demand for long-term fixed interest and index-linked assets is likely to be offset by schemes continuing to de-risk their investments, as outlined above, typically through moving from equities to less risk fixed income assets.

Proportion of transfers

32. For the large majority of individuals, remaining in their DB scheme will be in their best interests financially. DB pensions offer a secure income in retirement including protection against inflation and investment risks, unlike for DC pensions. Further, transfer values offered to individuals wishing to move from a DB to DC pension are often lower than the net present value of the benefits an individual would receive from their DB pension.

33. Nonetheless, it will still be rational for some individuals to decide to request transfers out of defined benefit schemes. Along with the value offered by a scheme to an individual to transfer, the individual circumstances which may result in an individual seeking to transfer from a DB to DC scheme include (but are not limited to) the following:

- they are heavily in debt
- they have a short life expectancy – an individual who believes that they have shorter than average life expectancy given their age could gain potentially gain more by transferring out of a defined benefit scheme
- they want to have their accrued benefit as wealth rather than a constant income stream, or unevenly spread throughout their retirement
- they are unmarried and do not have dependants

34. Currently approximately 20,000 people transfer from a private sector DB pension scheme per year. Discussions with stakeholders during the consultation highlighted a range of estimates for the proportion of those that would seek to transfer from a private DB scheme following the introduction of wider flexibilities for DC schemes. The majority of these were between 10% and 20%, but with a number expecting transfers to be below 10%. This is also consistent with qualitative discussions during the consultation that stakeholders had not seen a significant increase in requests for transfers out of DB schemes.

35. Section 3 below discusses the detailed modelling and specific assumptions used to derive the costs and benefits of the policy option pursued in the remainder of this IA.

Asset base affected by DB transfers

36. Currently, existing (as opposed to future) pensioners are excluded from the right to transfer. This is because of the significant adverse selection risk of allowing current pensioners to transfer out of their defined benefit schemes which would place significant risk onto the pension fund, and would be unfair to remaining members, and could require schemes to increase their funding requirements.

37. The Government therefore decided to retain the current exclusion of existing pensioners from the right to transfer. Netting out pensions in payment from the total asset base reduces substantially the amount of assets potentially subject to transfers.

Timing of transfers out

38. The timing of any transfers out of a defined benefit scheme will also make a difference to the impact on scheme investments. It is reasonable to assume that members of private sector defined benefit pension schemes who wish to transfer would benefit by doing so as

close as possible to the point they crystallise their pension. This is because it is unlikely that transferring to a defined contribution scheme earlier in life would lead to greater pension wealth in retirement compared to accruing more years of defined benefit pension, or, for those with deferred benefits, benefitting from index linked up-lifting.[8] This means that any transfers would take place over a number of years, in line with the age profile of members, rather than at once.

Wider defined benefit investment trends

39. Discussions during the consultation highlighted a number of trends in the investments that DB pension schemes make. In particular, there has been a significant trend of de-risking by these schemes, including moving from risky assets such as equities into fixed-income assets. This has been driven by a number of factors, including regulatory and accounting changes. But it has also been driven by trends in longevity, with individuals living longer schemes need to secure a safer guaranteed income to fund DB pensions; and also due to the maturity of schemes increasing, with most DB schemes closed to new members (and some to future accruals). This means that as scheme members' age, and with more in retirement, scheme liabilities are more predictable and therefore schemes have been moving into less risky investments that are better matched to their liabilities. This trend has also led to an increase in demand from DB schemes for both government and corporate bonds.

40. Separately, introducing a ban on transfers would reduce companies' ability to manage their liabilities by de-risking their defined benefit schemes via a policy of encouraging their members to leave on fair terms, and thus reducing their exposure to longevity risk. By hampering companies' ability to manage their balance sheets in this way, there is a risk that a ban on transfers could hold back companies risk appetite and ability to invest, with potential knock-on effects for job creation and growth. This would in turn create significant additional burdens in schemes needing to find additional ways to manage their liabilities, or expose schemes to greater risk of instability or insolvency.

Conclusion

41. Taking into account the factors outlined above, namely: the exclusion of pensioners from the right to transfer; the limited number of active and deferred scheme members for whom it would be in their best interests to transfer; and the likelihood that those transferring would do so when they reach the scheme's normal age for crystallising their pension pots, the Government assessed that the wider impact, on financial markets and the macro-economy, from continuing to allow private sector DB to DC transfers would most likely be manageable. As such, the Government judged that a full ban would be disproportionate to achieve the overall policy objective of providing individuals with greater freedom and choice in how they access their pension savings.

[8] Based on the Office for National Statistics' (ONS) Wealth and Assets Survey 2008-10, the mean average private sector DB pension for those aged 50-54 is around 50% greater than those aged 40-44. Therefore, remaining in one's DB scheme for as long as possible is likely to increase pension wealth at retirement.

Option (1): Status quo – retain ability to transfer with current safeguards in place

42. Individuals' current ability to transfer from a private sector DB scheme to a DC scheme manifests itself through a number of different channels for transfers, and with some requirements for individuals to receive financial advice prior to transferring. In addition, pension schemes currently have available to them powers over the terms of any transfer to help protect DB schemes' funding position.

43. This option is a baseline against which the Government's preferred option is analysed, in terms of the incremental costs and benefits the preferred option results in. The rest of this section explains in more detail the current requirements for taking independent financial advice alongside transferring from a DB to DC scheme and the powers available to pension fund trustees over the terms of such a transfer.

Current requirements for financial advice

44. Currently, transfers out of DB schemes can either be at the initiative of the scheme itself, or the individual in question. In large part, transfers on the initiative of the scheme are part of 'transfer exercises' in which schemes make a widespread offer to a proportion of their members on the terms of a transfer. As outlined above, this is an option open to schemes to help manage their liabilities associated with DB pension promises, including through reducing their exposure to longevity risks. In some cases, such transfer exercises offer 'enhanced transfer values' (ETVs), where members are offered a transfer value above that of the schemes' usual transfer value to encourage members to take part.

45. Currently there are no statutory requirements for the transferring scheme as to whether it needs to offer, or ensure take up of, financial advice prior to a transfer taking place. Where transfers are part of a transfer exercise, a Code of Good Practice was established in 2012 that stipulates that, where conducting incentive exercises (which include transfer exercises), employers must provide financial advice to their employees. The evidence that exists currently suggests that employers are abiding by the terms of the Code. In other channels for transfer, including those which are employee initiated, there does not exist a statutory requirement for providing advice.

46. On the other hand, qualitative evidence from industry suggests that most DC receiving schemes will not allow for an individual to transfer in from a DB scheme without having taken financial advice prior to the transfer, although this is not a statutory or regulator requirement.

Powers to pension schemes over terms of DB transfers

47. In addition, pension fund trustees currently have powers available to them over the terms of transfers out of their DB scheme. At present, pension fund trustees are able to ask the Pensions Regulator for a longer time to make transfer payments, if the interests of the members or the scheme generally will be prejudiced by making the payments within the usual period, such as due to funding or market conditions. In addition, trustees have the power to reduce the transfer value for switching from DB to DC to reflect the funding level of the scheme – for instance if a scheme faced a funding position of 70%, trustees would have the power to offer transfers at 70% of the CETV.

Option (2): Introduce additional safeguards to protect individuals and pension schemes

48. The Government's chosen option is to continue to allow DB to DC transfers for individuals in private sector DB schemes, subject to two additional safeguards to help protect individuals and pension schemes. These safeguards are:

1) to make it a statutory requirement on the transferring scheme for all individuals who are considering transferring out of DB schemes to take advice, from a professional financial adviser who is independent from the DB scheme and authorised by the Financial Conduct Authority (FCA)[9], prior to transferring.

2) the Government intends to work with the Pensions Regulator to ensure there is new guidance available to pension scheme trustees on the powers available to them around the terms of transfers to help maintain the sustainability of schemes.

Statutory requirement for financial advice

49. Whilst the Government believes that impact of allowing transfers from private sector defined benefit schemes is likely to be limited, it nonetheless wants to ensure that there are sufficient safeguards in place to minimise any potential risks. During the consultation a number of stakeholders – including the CBI, ABI and NAPF – who supported retaining the current right for private sector transfer suggested that current safeguards could be improved.

50. At present, although the majority of defined contribution schemes will only accept transfers if impartial financial advice is taken, guidance for transfers from defined benefit schemes only stipulates that impartial financial advice has to be taken when transfers are instigated by the employer, not when they are instigated by the employee. As outlined above, there is currently no requirement in legislation on a transferring DB scheme to provide advice to members wishing to transfer out to a DC scheme. Only in the case of transfer exercise is there a Code of Conduct that includes the expectation for advice to be offered to those alongside the transfer.

51. Although pension schemes have not indicated a significant increase in demand for transfers following the announcement of wider flexibilities, there are likely to be cohorts for whom it is in their interest to transfer. Further, the introduction of wider flexibilities may also increase the interest of those in considering transferring, irrespective of whether it is in their financial interest, due to the attraction of being able to access pension wealth sooner having transferred to a DC scheme. Given that this interest is likely to be largely employee initiated, the
Government believes that it is important to introduce measures to ensure individuals are well informed of the implications of transferring from DB to DC.

52. A statutory requirement for an individual to take advice prior to transferring will therefore ensure that individuals are fully informed of the implications of such a move. To ensure that the advice is not perceived as biased (for instance the individual may perceive that the scheme is encouraging them to transfer to manage their liabilities) the requirement will be for advice that is independent of the DB scheme, and authorised by the FCA.

53. For other channels to transfer – principally transfer exercises – although the evidence suggests that the current Code of Conduct, which sets out that advice should be provided when an employer initiates a transfer exercise, the Government sought to ensure simplicity

[9] The definition of impartial financial advisers includes independent financial advisers and financial advisers working in more specialist areas, for example specialist pensions transfer advice companies

for individuals and for schemes by applying the statutory requirement across all channels for transfers. Further, and as analysed in further detail below, given that the Code of Conduct is largely adhered to currently, the incremental cost to business from a statutory advice requirement covering these types of transfers is unlikely to be significant.

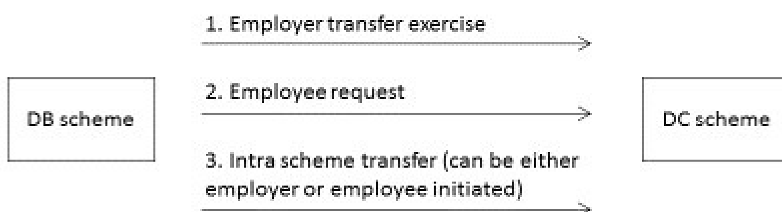
Paying for advice

54. Responsibility for paying for advice will fall on the employer if they chose to run a transfer exercise. This is because the Government judged that it would not be fair to expect pension fund members to pay for advice if the option of transferring is raised by the employer. Further, this is already codified in the Code of Conduct, and as outlined above, given that the evidence is that the Code is well adhered to, the incremental cost to employers is unlikely to be significant.

55. Similarly, the responsibility for paying for advice will also fall on the employer when transfers are between DB and DC schemes run by the same employer. This is to prevent employers who are seeking to de-risk by pro-actively advertising to their employees that they can transfer into a DC scheme to access all or part of their pension pot (potentially with an additional cash incentive). If this is done outside of an official transfer exercise, the employer could pass the cost of advice on to the employee. This requirement would close that loop hole and ensure employers didn't get employees to pay to help them de-risk their schemes.

56. In all other cases it will be for the pension scheme member to pay for the advice. As the potential interest in transferring from a DB to DC scheme is likely to increase following the introduction of flexibility for DC schemes, this will incur incremental costs to individuals, which is analysed in further detail in the costs and benefits section below. However, the Government judged these costs as proportionate given the greater benefit of ensuring individuals are fully informed of their available choices before transferring.

Figure 1: Channels for transferring from a DB to DC scheme and corresponding advice requirements



Current advice requirements		
Type of transfer	**Advice required?**	**Who pays?**
1. Employer transfer exercise	Yes, in Code of Conduct (not statutory requirement)	Employer
2. Employee request	- No requirement on DB transferring scheme - DC receiving scheme has to verify individual has taken advice (where DC scheme is FCA regulated)	Employee
3. Intra scheme transfer	Dependent on whose initiative	Either

Future advice requirements		
Type of transfer	**Advice required?**	**Who pays?**
1. Employer transfer exercise	Yes, statutory requirement	Employer
2. Employee request	Yes, statutory requirement for transferring scheme to verify individual has taken advice	Employee
3. Intra scheme transfer	Yes, statutory requirement to take advice	Employer

Read across to the guidance guarantee for individuals retiring with DC pensions

57. The requirement for financial advice contrasts to the Government's commitment to offer impartial guidance to individuals reaching retirement with DC pensions that would be free at the point of delivery. Guidance, as opposed to advice, is not a regulated activity and does not lead to a specific recommendation. Rather, the guidance for those with DC pensions aims to help individuals understand the range of choices available to them, along with the wider context for those choices, for instance the tax implications of taking up greater flexibility.

58. In response to the consultation, the Government decided that guidance would be provided by organisations that are independent, and have no actual (or potential) conflict of interest, for instance by also selling a financial product or service. In the same way, the Government has sought to ensure that the financial advice provided to individuals on transferring from a DB to DC scheme is independent of the transferring scheme, to ensure that there is no conflict of interest, for instance from a pension scheme seeking to encourage individuals to transfer where it is in their best interest, rather than the individual's.

59. The Government is working with the FCA on the standards that the guidance guarantee will be required to meet, although it has taken the decision that it would not be appropriate for the organisations that will deliver the guidance to be subject to FCA authorisation and regulation, as it is not intended to stray into areas such as specific product recommendations.

60. The Government recognises that allowing greater flexibility for individuals with DC pensions means there is a priority on ensuring individuals are sufficiently well informed of the range of choices available to them, and the implications of those choices. The Government can play an important role in enabling individuals to better understand these choices through the guidance guarantee, and that is why a Treasury-led delivery team will bring together a range of independent organisations (including the Pensions Advisory Service) to deliver guidance to individuals. The guidance will help to fill the gap that arises by an individual no longer being effectively required to purchase an annuity, as was previously the default choice for most individuals. In many cases the guidance will pave the way for more detailed discussions, including with a professional financial adviser, but the Government believes it has a role to play in setting out the initial context and choices for an individual at retirement through guidance, rather than advice.

61. However, while the Government wants as many people to be able to access the flexibility in DC pensions, the decision as to whether an individual transfers from a DB to DC scheme should continue to be subject to the more detailed requirements of regulated advice. This is because for the majority of individuals a DB pension will remain the most appropriate choice, and for an individual to transfer is a significant decision to give up the benefits and security that a DB scheme provides. The Government does not believe it should play a role in directly providing such regulated advice, but that it should place a duty on pension schemes to verify that it has been provided prior to an individual transferring from a DB scheme.

Trivial commutation

62. The requirement for financial advice only applies to individuals who are not able to take advantage of trivial commutation – that is, the ability to take their pension entitlement as a lump sum. The trivial commutation limit is currently £10,000 for a single pension arrangement, and £30,000 for overall pension wealth. From April 2015, for individuals in DC schemes there will no longer be a trivial commutation limit, as all restrictions in the tax rules on how an individual can access their pension will be removed. However, the trivial commutation limit will continue to apply to those with DB pensions (it is only after

transferring to a DC pension that the individual can access their pension flexibly), and only those above the trivial commutation limit will be covered by the requirement for financial advice outlined above.

Guidance to trustees on powers over the terms of transfers

63. The Government also intends to work with the Pensions Regulator to ensure there is new guidance available to trustees on the existing powers available to them, namely to: ask the Regulator for longer to make transfer payments if the interests of the members, or the scheme generally, will be prejudiced by making the payments within the usual six month period; and to reduce the transfer values offered to individual members to reflect the schemes current funding position. This will help ensure that trustees are fully aware of these powers and are prepared to use them should the need arise.

Option (2.1) introduce new powers for trustees over the terms of transfers

64. During the consultation period the Government received representations from some stakeholders that additional powers could be provided to scheme trustees over the terms of transfers from DB schemes, to help further mitigate the risks from an increase in number of people seeking to transfer.

65. On balance, the Government decided against introducing any additional powers to trustees, beyond those that are already within their remit. The Government recognised that this would place an additional regulatory burden on employer pension schemes, and one that it is not clear would be warranted. The Government instead would prefer to ensure that the existing powers available to trustees are understood and used where necessary. Given the future increase in transfers from DB schemes is uncertain, as are changes to the investment and funding strategies of DB pension fund trustees in light of the wider flexibilities, the Government has decided not to intervene further in providing additional powers to trustees over the terms of DB transfers, but instead will continue to monitor developments to gauge the extent to which any additional powers might be needed in future.

Conclusion

66. Taken together, the Government believes the two additional safeguards provided to DB schemes strike the correct balance between an additional regulatory burden, and managing the additional, uncertain risks from DB transfers in lights of the new flexibility for DC pensions. The safeguards provide additional reassurance for individuals, schemes and the wider economy while continuing to allow transfers from DB to DC pensions, the banning of which would not be a proportionate response to the likely risks and counter to the Government's wider agenda to promote freedom and choice in pensions.

Section 4: Costs and Benefits

Summary of the costs and benefits of each option:

Option 1: no change (baseline)
The baseline policy option has zero incremental costs and benefits
Option 2: introduce new safeguards while continuing to allow DB to DC transfers
<u>Monetised costs of option 2 (gross):</u> Annual cost to business from additional safeguards: £2.11m • Annual cost of providing additional financial advice required once made a statutory requirement: £1.67m • Administrative cost of verifying individuals have taken financial advice: £0.44m • Transitional and familiarisation costs of new safeguards: £0.29m • Annual cost to individuals from additional safeguards: £1.73m <u>Monetised benefits of option 2 (indirect effect):</u> • Annual indirect benefit to professional financial advisors offering financial advice from requirement to take advice and additional individuals seeking to transfer: £3.39m <u>Non-monetised benefits:</u> Individuals will be better informed of their choices and implications of transferring from a DB to DC pension scheme, reducing the risk that individuals transfer against their best interest. The risks of instability for DB pension schemes from individuals transferring will be reduced, and pension scheme trustees will be better informed of the powers available to them to mitigate the impact of individuals transferring out.

67. All of the cost and benefit estimates below are incremental to the baseline – option (1) – described in paras 29 to 42 above (which has zero costs and benefits relative to itself). The section below considers the costs and benefits of the Government's preferred option – option (2) – described in paras 43 to 50 above.

Assumptions and analysis to derive costs and benefits

Central assumption for take up of DB transfers

68. The critical assumption this IA has made in order to subsequently derive estimates of the costs and benefits of new safeguards is about the number of people who will choose to transfer from a private sector DB scheme to take advantage of the new freedoms, and over what timescale.

69. As discussed in earlier sections, analysis and discussions with stakeholders have shown that there is unlikely to be a significant increase in demand for transfers out of DB schemes once wider flexibilities for DC schemes have been introduced. There are also further factors that affect the timing of when individuals are able, and are likely to choose to transfer, which also points towards the proportion of those seeking to transfer as not being large. First,

individuals are not permitted to transfer out of DB schemes after they have begun drawing their pension. Second, we assume that very few people would choose to crystallise their DB pension while they are still accumulating DB rights, since these are typically much more generous than the return they could achieve outside a DB scheme. Therefore, the individuals who would transfer out are assumed to flow out of DB schemes gradually, as they reach retirement age.

70. The demand for transfers that is observed will depend on the transfer value offered, and the individual's specific financial circumstances and preferences.

71. Transfer values offered by employers represent the capital cost of meeting the future pension liability, which depends on a variety of factors, including scheme benefits, market conditions, mortality assumptions and the position of the scheme. External analysis has argued that the 'typical' figure for CETVs varies between 60% and 90% of the actuarially fair value of DB pension rights within a scheme[10]. The analysis used in this IA is based on an assumption of an average transfer value of 80% of the actuarially fair value. Details of the further analysis underpinning this assumption is presented in Annex B.

72. Based on an average transfer value of 80%, HMRC analysis used this assumption to calculate the resulting proportion of individuals within DB schemes that would look to transfer to a DC scheme following the introduction of wider flexibilities for DC pensions. In general, an individual would seek to transfer from a DB to DC scheme to take advantage of greater flexibility according to how their own financial circumstances impact the extent to which income sooner is in their interest.

73. HMRC segmented the population according to where their greatest source of net wealth is held, and assumed a discount factor for each segment based on Bank of England data and OBR determinants. They then used these discount factors to estimate whether an individual would rationally chose to take their income sooner rather than later through their defined benefit rights. Those groups that would be better off by taking their income sooner rather than via an annuity or DB benefits are those with debt (including high cost debt e.g. credit cards, low cost debt e.g. secured loans, or other debt such as mortgages); or those with investments that would generate a higher rate of return than from keeping their pension entitlement invested by the scheme.

74. HMRC estimated the critical CETV (as a percentage of the cost of annuity that would be required to cover the full value of the DB rights forgone) that would be required in order for members of each group to be willing to transfer, by using the appropriate discount factor to estimate the net present value of future DB rights. Assuming an average CETV of 80% is estimated to incentivise 7.6% of those individuals whose DB pensions are crystallising to transfer to a DC scheme. (See Annex B, page 35)

75. There are around 120,000 private sector DB pensions crystallised each year, and the increased flexibilities are therefore forecast to lead to an increase of 9,000 people transferring from private sector DB to DC schemes.[16] Since the flexibilities are estimated to only impact those who are about to become entitled to their DB pension, the 7.6% proportion is applied to the total number of private DB pensions crystallised each year. As previously noted, those whose pensions have already 'crystallised' are not eligible to transfer; those who are some way off crystallising are unlikely to transfer as this deny them of the future accruals under a DB scheme.

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[10] Towers Watson (2014), http://www.towerswatson.com/en-GB/Insights/Newsletters/Europe/UK-Corporate-Briefing/2014/05/The-future-of-DB-toDC-transfers

[16] The population of DB pensions crystallising each year is estimated by HMRC based on data from the Wealth and Assets survey (2012) http://www.ons.gov.uk/ons/rel/was/wealth-in-great-britain-wave-3/2010-2012/index.html

76. The increased pension's flexibilities could also create an incentive to transfer for those wishing to retire early; such as those in ill health. There is a lack of data as to the number of individuals with DB schemes who do retire early, however, we would expect the figure to be relatively small and therefore have assumed that this does not have a significant impact on the overall additional number of transfers outlined above.

77. A number of further factors will also influence demand for transfers in addition to the discount factor, including:

- Liquidity preference
- Bequest motive
- Difficulty of transferring
- Lack of awareness of the availability of transfers
- Pension scheme and employer behaviour (employers could encourage people out if they want to de-risk or reduce transfer values if they want to retain current members.

78. HMRC assessed that the combined impact of the factors above would be likely to net to zero and therefore did not include them in their analysis. A full set of HMRC's assumptions (and alternative methods with which to calculate CETV values) is given in Annex B and is subject to OBR revision before Autumn Statement.

Forecasting the impacted populations

79. In order to analyse the costs and benefits of the DB transfer safeguards, we need to know through which channel these transfers are currently made and forecast how future additional demand will be distributed across each of those channels. The section below sets out analysis of the current and future cohorts of individuals transferring across each available channel; this is summarised in Table 1 below.

Current populations of individuals transferring across each channel

80. There are currently around 20,000 transfers from private sector DB schemes each year. Of these current transfers, data exists only for the number of transfer exercises, which numbered 3,828 in 2012-13 (around 19%).[11] As such, we have had to derive estimates of the number of intra-employer and employee-initiated transfers.

81. For intra-employer transfers, this is derived from data on the total number of employer pension schemes that offer both DB and DC arrangements, which is around 37%. This therefore denotes the population of schemes within which intra-employer transfer exercises are possible. As such, we assume that intra-employer transfers make up 37% of the remaining transfers each year, once transfer exercises have been taken out. This equals 5,983 (37% * (20,000 – 3,828)). Employee-initiated transfers is the remainder, which equals 10,188.

82. It is also worth noting that some transfer exercises will also be intra-employer. This therefore means that the number of intra-employer transfers which need advice is likely to be lower than our estimate of 5,983 (as all of the transfer exercise transfers receive advice, compared to 90% of the intra-employer transfers). If 10% of intra-employer transfers were actually transfer exercises, then, in the post-flexibility world, this would represent an additional 60 people who would already have financial advice and as such would not be impacted by this measure. However, as we have no data as to this split, we have maintained

[11] The Pensions Regulator (2014) scheme returns on transfer exercises from 'The Pensions Register'

the divide between the two and this therefore represents a relatively conservative figure for forecasting the impact on intra-employer transfers.

83. There is a further issue around whether the number of transfers accurately reflects the number of individuals currently taking advice. It is likely that there is a section of the DB scheme population who take out professional financial advice, but do not then take up a transfer – these individuals are not included in the 20,000 figure. No data exists on the number of individuals who take out financial advice but do not then transfer. Furthermore, it does not impact the provision of professional financial advice pre- and post- introduction of additional safeguards, because, by definition, these individuals have already received advice.

Forecasting the distribution of future demand for transfers

84. For the purposes of modelling the impact of the extra 9,000 transfers expected to take place following the introduction of the pension's flexibilities (the increase of 7.6% of crystallising DB pensions as forecast by KAI through CETV analysis), we have assumed that the proportions between each type of transfer will increase at the same rates. This therefore maintains the current proportions for each channel (i.e. transfer exercises account for 19% of present day transfers, and will account for 19% after the introduction of flexibilities).

85. There are some uncertainties around this assumption. For instance, the impact of higher demand for DB transfers on the incentives which businesses face for engaging in transfer exercises is uncertain. On the one hand, it does not alter the firms' incentives directly, as these relate to the funding position of the employers DB scheme. However, on the other hand, the likelihood that people will take up an incentive exercise offer could increase. Given the overall effect is uncertain, we continue to maintain the same proportion of transfers through each channel. This leads to an anticipated 5,551 transfer exercises (an increase of 1,723); 8,676 intra-employer transfers (an increase of 2,693); and 14,773 employee-initiated transfers (an increase of 4,585) out once DC flexibilities are introduced.

86. As noted in paragraph 81, there is also an issue around whether the number of transfers is representative of the number of individuals taking out professional financial advice. It is likely that there is a section of the DB scheme population who take out professional financial advice, but do not then take up a transfer; these are not included in the 9,000 figure. As previously stated, data does not exist for the number of individuals who do take out advice without later transferring. Again, this is not expected to affect our baseline case for specific impacts from introducing mandatory professional financial advice, because this sub-section of the pension's population, by its nature, already takes out/receives advice; the additional individuals taking out the advice without transferring are as a result of the increased flexibilities.

87. Furthermore, it is likely there will be some individuals who do not act economically rationally and, even having received advice that suggests transferring is not in their financial interests, do so anyway. As such, this effect combined with that in para 87 above, operate in conflicting directions. Therefore, for the purposes of this IA, we have maintained the central figure of 9,000 extra transfers.

Table 1: Current and future estimates for numbers transferring through each channel[12]					
	Latest data (2012/13)	Percentage	Post-flexibility transfers (2015)	Absolute change	Percentage
Total transfers	20,000		29,000	9,000	
As part of a transfer exercise	3,828	19%	5,551	1,723	19%
Intra-employer	5,983	30%	8,676	2,693	30%
Employee transfers out	10,188	51%	14,773	4,585	51%

Costs of option 2: introduce additional safeguards to protect individuals and schemes

88. The main impacted groups would be employers operating DB schemes and scheme members. There would be two main impacts on employers, through: the additional requirements to provide (and fund) advice for transfer exercises and intra-employer DB to DC transfers; and the administrative cost of verifying that scheme members have taken advice for transfers instigated by the individual. The box below summarises the derivation of costs for businesses from the additional safeguards.

89. In order to derive the additional cost to business, on the basis of the populations estimated above, the analysis next needs to consider the cost of advice itself, where the employer is required to pay, and estimate the number of additional people that will require advice who are not receiving it currently.

Cost of financial advice

90. Across both employer transfer exercises and intra-employer transfers, the cost of providing any additional advice falls to the employer. For the purposes of estimating these costs, we have discussed with the Pensions Regulator and Association of Professional Financial Advisers to derive an estimate of the likely unit cost of financial advice. The average cost of financial advice used in this analysis is £156 per hour, and the average time required for advice is 7.5 hours. This results in a cost per unit of advice of £1,170, to be borne by the employer or employee depending on whose initiative a transfer is. Furthermore, a small sample survey conducted by APFA on our behalf corroborated the figure used in this analysis.

91. There are some risks around this analysis. On the one hand, the new requirement for financial advice is that it is from a professional financial adviser authorised by the FCA. In some cases, although financial advice is currently offered, it may not always be by advisers authorised by the FCA. As such, there may be costs to advisers of authorisation. On the other hand, discussions with the FCA have highlighted that the costs above are likely to overstate the costs of advice when it is provided by employers, due to economies of scale in providing advice to a number of individuals and lower costs of information gathering for the adviser (which can be done by the employer). Given these two effects work in opposite directions, we assume they broadly balance and maintain a central assumption of advice at £1,170 per individual transferring.

92. Furthermore, research by DWP suggests that employers often factor in the cost of providing financial advice into the CETV value offered to the employees. As such, employees implicitly pay for some of the financial advice provided within transfer exercises

[12] Numbers may not always sum exactly due to rounding.

through a reduced pay out and the actual incremental cost impact is likely to be lower than the headline figure.

Summary of derivation of costs to business from additional DB safeguards

The incremental cost to business from the new requirements for financial advice are calculated as follows:

*Change in costs = Change in number of people transferring and requiring advice * cost of providing or verifying advice*

Where the change in the number of people transferring is explained in the analysis in table 1 and the preceding section on forecasting current and future proportions of transfers.

And where the change in cost of providing or verifying advice is calculated through the three channels for transfers in figure 1 above, as follows:

1. Employer transfer exercises

*Change in costs of providing advice = Proportion of transfers through transfer exercises * (1 – proportion of people receiving advice currently through Code of Conduct) * Cost of advice*

2. Intra-scheme transfers

*Change in costs of providing advice = Proportion of additional intra-scheme transfers requiring advice * Cost of advice*

3. Employee initiated transfers

*Change in costs of verifying advice = Proportion of transfers through employee initiatives (includes intra-employer) * Admin cost of verifying employee has taken advice*

1) Costs to employers of providing financial advice

Transfer exercises

	Present day (2012/13)	Proportion who receive advice at present	Post-flexibility transfers (2015)	Advice received if there were no mandate (2015	Additional advice needed to fulfil mandate
As part of a transfer exercise	3,828	3,445 (90%)	5,551	4,996 (90%)	555 (10%)

93. With regards to transfer exercises, a Code of Good Practice was created in 2012 which expected all future incentive exercises (which includes transfer exercises) to follow the spirit and principles of the Code and not look for creative ways to work around the Code. The Code stipulated that, when conducting incentive exercises, employers must provide advice to their employees. There is little evidence to date of employers not using the Code or creatively avoiding its requirements. In particular, this is due to the Code of Conduct having made transfer exercises appear to be a more respectable course of action, meaning that

firms see the code as supporting their ability to involve members in transfer exercises, thereby implicitly ensuring they subscribe to its tenets.

94. Furthermore, a thematic review of ETVs between 2008 and 2012[13] found that most employers already paid for the financial advice in relation to an ETV pension transfer before the Code of Conduct came into being. As such, it is likely that take up of IFA is already very close to 100%. However, the FCA study also highlighted that some advice was of poor quality. This measure also ensures that the financial advice received will now need to be provided by a professional financial advisor authorised by the FCA; this will likely increase the number of firms which, within our baseline, do not provide advice that meets these requirements (as those firms which provided financial advice below the quality authorised by the FCA would have to seek FCA authorised, and likely more expensive, advice).

95. Therefore, given the competing factors around the quality and coverage of advice, we do not think it is reasonable to assume that current take-up is 100% at the quality that will be required following the new safeguard. Instead, we assume a central figure of 90% provision currently of financial advice.

96. Following the statutory requirement, we assume that 100% of individuals transferring through a transfer exercise will receive advice. Therefore, the additional number of people that will require advice through transfer exercises as a result of the introduction of the new safeguard is 10% of those who transfer following the introduction of wider flexibilities – equal to 555 more individuals. As such, our central estimate is that the impact upon businesses for making financial advice compulsory when the transfers are part of incentive exercises is likely to be £0.65m (cost of advice (£1,170) * 10% * the number of individuals expected to take part in a transfer exercise (5,551).

Risks around the central assumption

97. To consider the risks around this assumption, we also estimate costs if the true adherence to the Code of Conduct is significantly lower currently – at 75%. In this instance, the incremental cost from making the provision of advice compulsory is £1.62m per year. This is calculated by taking the estimated of cost for advice of £1,170 (£156ph x 7.5hrs) x 25% x the number of individuals expected to take part in a transfer exercise (5,551).

Intra-employer transfers (non-Transfer Exercise)

	Present day (2012/13)	Proportion who receive advice at present	Post-flexibility transfers (2015)	Advice received if there were no mandate (2015)	Additional advice needed to fulfil mandate
Intra-employer	5,983	5,385 (90%)	8,676	7,809 (90%)	868 (10%)

98. As previously stated, currently, around 37% of pension schemes operate both DB and DC arrangements for members. As such, we assume that 37% of employee initiated transfers are to DC schemes operated by the same employer, since employees would only be able to transfer within a scheme run by their employer where it exists. This results in an upper bound of 8,676 people who we would expect to potentially transfer intra-employer as a result of the new flexibilities.

99. Consultation with the industry suggests that most schemes already insist that a new member receive financial advice before accepting a transfer from a DB scheme. As above, although it

[13] FCA (2014) 'Thematic Reviews - enhanced transfer value pension transfers' http://www.fca.org.uk/news/thematic-reviews/tr14-12-enhancedtransfer-value-pension-transfers

does not appear feasible to use a central assumption of 100% coverage, we use a central value of 90% which forecasts that schemes would have to fund additional advice for 10% of intra-employer transfers. This represents 868 transfers at a cost of £1.02m per year based on a unit cost of advice of £1,170.

Risks around this central assumption

100. To consider the risks around this assumption, we also estimate costs if the true take up of financial advice is significantly lower – at 75%. In this instance, the incremental cost from making the provision of advice compulsory is £2.54m per year. This is calculated by taking the estimated of cost for advice of £1,170 (£156ph x 7.5hrs) x 25% x the number of individuals expected to take out a transfer intra-employer (8,676).

Administrative costs in ensuring employees have received advice before transferring

101. The second source of costs to businesses arises from the administrative burden associated with verifying whether scheme members have received advice before initiating a transfer. The administrative cost arises from the average time taken to verify an individual has taken advice, and the labour cost of that time for the average pension scheme administrator.

102. Labour cost was calculated through use of the Green Book's ASHE system which records average wages for various professions. Recognising that pension's administration is likely to be a higher wage paying profession than general administration, we used the wage data from the Annual Review of Households and Earnings data (2013) with regards to Associate Professionals with an annual salary of £30,284. This was then increased by 27%, in line with the approach set out in the Green Book, to account for non-wage labour costs such as national insurance and pensions. This results in an administrative cost of £18.91 per each hour required for a pensions administrator to verify that advice has taken place.

103. During the construction of this IA, we were unable to establish more accurate numbers for the length of time it would take a pensions administrator to check as to whether an individual has taken advice. We have therefore used 1 hour as a central estimate for the amount of time this could take. We regard it unlikely that this sort of procedure would take longer as the options available for its implementation largely revolve around interviews and forms; neither of which we anticipate take longer than an hour to process. Therefore, the administrative cost amounts to £18.91 for each member verification is taking place.

104. Assuming that verification is only needed for those employees who transfer outside of a transfer exercise (as those employees involved in a transfer exercise are getting financial advice arranged by the employer, and therefore verification is not needed as the whole transfer is processed by the employer), 23,449 members will transfer per year under the new scheme at the above price of £18.91 per member, with a total expense of £0.44m per year.

105. Furthermore, it would take the central estimate of these costs to expand around 226% for them to be greater than a £1m administrative burden to businesses – a factor that does not appear feasible.

Risks around this central assumption

106. To consider the risks around this assumption, we also estimate costs if the true time it takes to verify that IFA has been taken is substantially longer – at 2 hours. In this instance, the incremental cost is £0.89m per year. The costs could also be smaller than expected, if the true time it takes to verify that IFA has been taken is substantially shorter – at ½ an hour, then the incremental cost is estimated at £0.22m.

Costs to individuals in paying for advice

	Present day (2012/13)	Proportion who receive advice at present	Post-flexibility transfers (2015)	Advice received if there were no mandate (2015)	Additional advice needed to fulfil mandate
Employee transfers out	10,188	9,170 (90%)	14,773	13,296 (90%)	1,477 (10%)

107. In cases where the request to transfer from a DB scheme is instigated by the individual within an employer's scheme, the cost of advice is borne by the individual. Consultation with the industry suggests that most recipient DC schemes already insist that a new member receive independent financial advice before accepting a transfer from a defined benefit scheme.

108. Therefore the incremental effect for those transferring should be relatively small.

109. Accordingly, we have estimated that 90% already take advice. Assuming the proportion stays the same, the incremental cost to individuals is therefore of estimated transfers, less the incremental transfers that will be funded by employers. Based on the assumptions above this would imply 1,477 employees requiring advice who previously did not receive it at a total cost to them of £1.73m. This is calculated by taking the estimated cost for advice of £1,170 (£156ph x 7.5hrs) x 10% x the number of employees expecting to transfer out (14,773).

Risks around this central assumption

110. To consider the risks around this assumption, we also estimate costs if the true take up of financial advice is significantly lower – at 75%. In this instance, the incremental cost from making the provision of advice compulsory is £4.32m per year. This is calculated by taking the estimated cost for advice of £1,170 (£156ph x 7.5hrs) x 25% x the number of employees expecting to transfer out (14,773).

Summary

111. Below is a summary table for how these costs work through to the various transfer channels.

Table 2: Summary of future estimates for cost of additional IFA required

	Post-flexibility transfers (2015)	Proportion expected to receive advice due to mandate	Additional advice/admin once mandated	Central estimate for cost of providing IFA (priced at £1,170 per person)
Total transfers	29,000	100%	2,900 (10%)	£3.83m (to business - £2.11m)
As part of a transfer exercise	5,551		555 (10%)	£0.65m
Intra-employer	8,676		868 (10%)	£1.02m
Employee out (employee pays)	14,773		1,477 (10%)	£1.73m

Admin cost	23,449[14]		23,449	£0.44m

Familiarisation and transitional costs

112. It is anticipated that scheme administrators will face some familiarisation and transition costs as a result of the changes.

113. First, there will be small costs to account for the time taken to familiarise themselves with the new statutory requirement for individuals to have received financial advice prior to transferring. This will likely consist of information published on the TPR website to refer to as required. Assuming that this information is approximately 2 pages in length, then, based on an average reading ability of 300 words per minute, 2 pages would result in roughly an additional 5 minutes of work for the pensions administrator to familiarise themselves with the new regulations. We then assume an extra 10 minutes for an individual to understand and digest the additional information. Based on administration costs of £18.91 (methodology as above) per hour, this would result in extra one-off costs for familiarisation to the business of £4.74 per DB scheme. This would only apply to each DB scheme rather than each member taking part in an exercise, as such the estimated cost is equal to £4.74 * the number of DB schemes = £4.74
* 6,910 which equates to total familiarisation costs of £32,750 to business.[15]

114. To consider the risks around this assumption that the advice will be 2 pages in length, we also estimate costs if it will be significantly longer – at 8 pages. This would result in total familiarisation time of 30 minutes as opposed to 15, thereby increasing cost to £65,600. This is calculated by taking the estimated cost of £18.91 per hour for administration x 0.5 x the number of DB schemes (6,921).

115. Second, there may be some transitional costs associated with scheme administrators changing the information that they send out to members requesting a transfer. Again, it is unlikely that substantive system changes will be required for this purpose but schemes may have to amend the communications they send out to members. We expect this would involve adding a simple statement to existing communications and would not increase the cost of sending this communication as the amount of paper and postage would remain the same (or not be relevant if schemes use e-communications). Therefore the system change costs to each scheme are likely to be negligible. Possible costs from changing communications have been estimated on the basis of the work taking 2 hours at a cost of £18.91 per hour (as set out above) for each of the 6,910 DB schemes. This equates to transitional costs of £261,336 to business.

116. Third, there may be transitional costs for administrators setting up a method for recording whether the member has taken advice. Again, there are unlikely to be any substantive systems change required, with the likely implementation being an addition to the staff record system allowing employers to confirm that they have received financial advice. As such, our forecast is that implementation changes will be of negligible cost to the employer.

117. Finally, there will be a cost for pension scheme administrators of familiarising themselves with the second safeguard being introduced – the guidance issued by the Pensions Regulator around those scheme trustees' existing powers over the terms and timing of any transfers. The length and substance of this guidance is still being developed, but it is not expected to be substantial. Furthermore, as the guidance is simply a restatement of existing

[14] Required for all transfers except transfer exercises where this is already included with IFA cost (and, by running the exercise and enacting the transfers, the employer already checks that they have received IFA).

[15] Data on the number of DB schemes is taken from 'The Pensions Regulator (2014) 'Scheme Return Data 2013/14'
http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-a-presentation-of-scheme-return-data-2014.aspx

powers that are available to trustees, which trustees are already likely to be familiar with, we expect there to be negligible familiarisation costs associated with this new guidance.

118. We therefore estimate total transitional and familiarisation costs in a central scenario of £0.29m (£32,750 + £261,336), with a higher bound of £0.33m (£65,600 + £261,336).

Benefits of option 2: introduce additional safeguards to protect individuals and schemes

119. The main affected groups that benefit from the preferred option are pension schemes, individuals and businesses that incorporate financial advisers, including a business comprising a self-employed individual as a financial adviser.

Monetised benefits to financial advisers

120. The other main group that benefits from the policy change is financial advisers. This is a second-order, indirect effect upon financial advisors and is therefore not included in the EANCB calculation. These benefits occur through a reallocation of resources that would have otherwise been used elsewhere, and therefore do not represent a direct benefit to business.

121. The monetised benefit to financial advisers is the opposite of the costs to employers and individuals from paying for advice, which is analysed in the section above. That is, the benefit to financial advisers can be calculated by the following:

Benefit to financial advisers = additional requirement for advice * value of advice

Where: ***value of advice = unit cost of advice * length of advice session = £1,170***

122. To derive the central estimate we use the same increase in number of people requiring advice, as a result of the statutory requirement, of 2,900 per year, based on the central assumptions above for the take up of advice currently. Factoring in the average unit value of advice also used above of £1,170 generates quantifiable benefits of £3.39m per year for financial advisers - financial advisers reap the full benefits of additional advice required from those wishing to transfer.

Risks around the central assumption

123. To consider the risks around this central assumption, we take a similar approach to that for the costs estimates. If the current take up of advice is at the lower bound used in sections above (of 75% take up as opposed to 90%), then that would generate 7,250 additional individuals requiring advice following the introduction of the statutory requirement. Using the same unit value of advice that generates an upper bound for monetised costs of £8.48m. On the other hand, if current take up is higher, at 100%, the additional benefit to financial advisers is zero.

Non-monetised benefits to individuals and to pension schemes

124. More broadly, the introduction of a statutory requirement for advice alongside DB transfers will ensure individuals are better informed of the choice available to them to transfer from a DB to DC scheme, and will help to limit the risk that individuals transfer where it is not in their best financial interest. While not quantifiable, as the benefit to any individual would depend on their level of financial literacy and unique preferences (such as for wealth versus cash), this element was an important consideration in the overall policy

consideration and ensuring that the wider objectives for greater freedom and choice in pensions were maintained.

125. The benefit for pension schemes themselves is also not easily quantifiable. To the extent that the requirement for financial advice ensures that individuals do not transfer from a DB scheme where it is not in their financial interest, this will help to limit the risk of a more substantial increase in transfers out that would result in destabilising of some schemes in crystallising a larger portion of their liabilities. Similarly, the issuance of new guidance will help to ensure that pension fund trustees are better informed of the powers available to them over the terms and timing of transfers out of their scheme. This will also help to reduce the risks that any transfers out destabilise the scheme. In that sense, the benefit to schemes is defined by the impact on the probability of instability, or insolvency – a probability that itself is not possible to quantify, and where the subsequent impact of greater stability is also not possible to quantify.

Interaction between costs and benefits

126. When considering the benefits of the additional safeguards, it should be noted that the scale of the benefits, whilst indirect, are likely to increase with a corresponding increase in the costs. For instance, the costs of adhering to the requirement to take financial advice are increasing in the proportion of individuals that do not currently receive advice (for instance due to a lower adherence to the Code of Conduct than evidence suggests). A lower proportion of individuals currently receiving advice, while increasing the cost of ensuring full coverage, also increase the benefits to individuals, schemes and financial advisers.

127. This is also the case similarly for the introduction of new guidance to trustees on the powers available to them over transfers. If understanding of the current powers is lower than currently assumed, then the familiarisation costs will be higher, but so too will be the incremental benefits of improving fund trustees' understanding of the powers available to them.

Section 5: Wider impacts

Impacts on Small and Micro Businesses

Costs

128. Data from DWP's case study exercise[16] into transfer exercises noted that the proportion of SMEs with defined benefit schemes is significantly lower than large employers; roughly 40% of larger employers have a DB scheme, as opposed to 5% of SMEs. Furthermore, it is likely that the figure will be smaller still for small and micro businesses, as a significant proportion of the 5% noted in the case study exercise are likely to be medium sized firms.

129. In addition, for the small number of small and micro businesses who do operate DB schemes, the cost of introducing the requirements to take financial advice is likely to only be related to the administration requirement. Small and micro businesses are highly unlikely to undertake transfer exercises, which are in general undertaken by larger DB schemes to manage the liabilities across a significant member and liability base. Similarly, it is highly unlikely small and micro businesses would run both a DB and a DC scheme for their members. Therefore, it is highly unlikely that costs will fall on small and micro businesses from the requirement to pay for scheme members' financial advice when transferring through these channels.

130. Whilst we anticipate that this will impact very few small and micro businesses, we still want to ensure universal coverage of the requirement to take out professional financial advice. Whilst the likelihood of those small and medium sized businesses having both a DB and DC scheme or conducting a transfer exercise (both options where the business would have to pay for advice) is minimal, there could still be individuals looking to transfer out of their DB scheme. These safeguards are being introduced to ensure that all employees are able to fully consider the pros and cons of transferring to a DC scheme (as it is frequently within individual's best interest to remain in a DB scheme), and we therefore would not want to exempt small and micro businesses from this requirement.

131. Furthermore, as noted above in the familiarisation and transitional costs section, it is not anticipated that substantial changes to equipment, processes or systems will be needed as a result of this change: the ability to acknowledge that an employee has taken financial advice will need to be added to their employee record, however, this is the only additional systems change that this measure creates. Therefore, we do not expect that the incremental cost to small and micro businesses to be a significant portion of the overall costs from these measures.

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[16] DWP (2014) 'Pension Incentive Exercises – Code of Good Practice Case Studies' https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/318782/pension-incentive-exercises-case-studies.pdf

132. Overall, therefore, we do not anticipate a significant impact on small and micro businesses in terms of cost; whilst we do not have the data relating to the precise number of small and micro firms running DB schemes, it is likely to be significantly less than the 5% which includes medium sized firms. Furthermore, even the small minority of forms which do run DB schemes, they are extremely unlikely to also run a DC scheme or take part in a transfer exercise, meaning the bulk of the impact of this measure would fall on their employees.

Benefits

133. On the other hand, we do expect a higher proportion of the indirect benefits of these measures to accrue to small and micro businesses. The average size of a financial advice firm is 4.53 people, with 11% of advice firms registered as sole traders.[17] Therefore, a substantial proportion of this additional business will accrue to small and micro businesses.

134. Further, there is unlikely to be any benefit to small and micro businesses from extending the transition period for this measure for them. There are only likely to be minor changes that need to be made to systems, and as such a longer transition period would likely have no effect on mitigating the impact of this measure. The same reasoning applies to allowing a temporary exemption to small and micro businesses; the transition costs are minimal and therefore the timing of when they occur is not expected to have a significant impact upon firms.

135. As such, we have concluded that small and micro businesses should be included within the scope of this regulatory measure in order to both achieve the overarching purpose of the policy, and because the impact on them is likely to be minor and significantly outweighed by the benefits accruing to financial advisors, a substantial proportion of whom are small and micro businesses.

Impact on the exchequer

136. The policy to continue to allow transfers from private (and funded public) DB to DC schemes will have an impact on the exchequer. Individuals transferring to a DC scheme to take advantage of flexibility increases tax revenues where individuals draw down more income from their pension than they would have done otherwise, for instance through an annuity, which is then taxed at their marginal rate. The impact of continuing to allow DB to DC transfers on the exchequer will be assessed and certified by the Office for Budget Responsibility (OBR) at Autumn Statement 2014. The impact of the additional safeguards covered in this IA will be included in that assessment.

Impact on financial markets

137. A key consideration in the wider policy decision to continue to allow transfers from private DB to DC schemes was the potential impact on financial markets, given private DB pension funds' role across a number of key asset classes, including gilts and corporate bonds. Engagement with stakeholders and analysis conducted during the consultation suggested that the overall impact on the existing DC asset base across financial markets is likely to be limited by continuing to allow private sector DB to DC transfers. The safeguards being introduced, by further limiting the risks to individuals of transferring when not in their financial

[17] APFA (2013), 'The Financial Adviser Market: In numbers', http://www.apfa.net/documents/publications/financial-adviser-market/apfa-the-financialadviser-market-in-numbers-v2.0.pdf

interest, and by mitigating the risks to schemes from transfers out, help to strengthen the assessment that continuing to allow DB to DC transfers will have only a limited impact on financial markets.

Section 6: Summary and implementation plan

Chosen policy option

138. In light of the consultation undertaken and analysis above, the Government has decided to proceed with option (2): continue to allow private sector DB to DC transfers with the addition of two safeguards, namely: to ensure provision of financial advice prior to transferring, and to work with the Pensions Regulator to issue new guidance to pension scheme trustees on the powers available to them over the terms of a DB to DC transfer.

Implementation plan

139. The Government will implement the safeguards for private sector DB to DC transfers through amendments to the Pension Schemes Bill.

Section 7: Other legislative amendments

140. This section covers an additional legislative amendment required to the Pension Schemes Bill to make the existing legislative framework operate correctly in the light of the additional flexibilities for DC pensions.

141. There are a number of further technical changes to existing pensions legislation being introduced, covering a range of areas, with several concerning the treatment of pension savings in the event of scheme failure relating to the Pension Protection Fund and Winding Up having no direct impact on business. Several of the other changes are permissive and therefore will only have an impact if schemes select to use the freedom the legislation allows. As schemes have not indicated whether they will use the freedoms it is difficult to quantify the potential impact but it is reasonable to assume schemes would only choose to use the flexibilities offered if it delivered benefits to them.

Amendment to provide for wider flexibility in DC pensions

Modification of Scheme Rules

142. To allow schemes to innovate and offer members' greater freedom and choice the government is permitting any occupational pension scheme where the new budget flexibilities apply to be able to offer income draw-down to members.

143. Most occupational pension scheme rules contain a power of amendment which allows them to modify their scheme rules. Where this power does not exist, Section 68 of Pensions Act 1995 (s68) sets the conditions which allow trustees to modify their scheme rules. This legislation will be used to allow scheme rules in all cases to be amended to enable income drawdown. This removes the need for schemes to conduct a costly consultation exercise with its members in order to achieve the change.

144. The impact of these changes is lower costs to members who are offered income drawdown within the scheme. By providing an over-ride to allow trustees and schemes to modify their existing scheme rules and reduce the burden on them to achieve the overall policy intent of providing more flexible ways for their members to access pension savings at a lower cost.

ANNEXES

Annex A – list of assumptions

Issue	Modelling assumption for this IA
Timing of transfers from private DB to DC pension schemes	Only those whose DB pensions are crystallising will consider taking advantage of the new flexibilities. Current pensioners are excluded from transferring, and it is assumed individuals will not seek to transfer before crystallising their pension, due to foregoing subsequent accumulation of DB rights.
Cash Equivalent Transfer Value (CETV) offered to DB scheme members to transfer	80% of the full value of DB pension entitlement is offered to those seeking to transfer to a DC pension
Additional number of DB scheme members who transfer at crystallisation	Based on an average transfer value of 80%, 7.6% (9,000) members of DB pension schemes crystallising each year will transfer to a DC pension
Impact of other factors on CETV	Assumed to net to zero
Number of intra-employer transfers	The proportion of schemes that offer DB and DC schemes (37%) is used as a proxy for the proportion of intra-employer transfers that currently take place
Overlap between intra-employer transfers and transfer exercises	No overlap assumed
Forecast for how number of additional DB members transferring is split across channels for transfer (transfer exercise, intra-employer transfer, employee-initiated)	Split proportionally across the three channels, therefore maintaining the same proportions as currently
Proportion of transfer exercises currently receiving financial advice	Central assumption of 90% of employees already receive financial advice from their employer. Lower bound of 75%
Proportion of intra-employer transfers currently receiving financial advice	Central assumption of 90% of employees already receive financial advice from their employer. Lower bound of 75%
Proportion of employee transfers out already receiving financial advice	Central assumption of 90% of employees already take out financial advice. Lower bound of 75%
Admin time for checking an individual has received financial advice	1 hour

Labour cost for administrator to verify advice has been taken	Associate Professional salary of £30,284, increased by TDI in line with Green Book methodology.
Cost of providing and offering financial advice	Assumed to be equal cost and benefit of providing advice. Average per hour cost of advice assumed = £156 Average time for advice assumed = 7.5 hours Therefore, unit cost of advice per member transferring = £1,170
Average reading speed	300 words per minute

Annex B – summary of HMRC methodology underpinning take-up assumptions

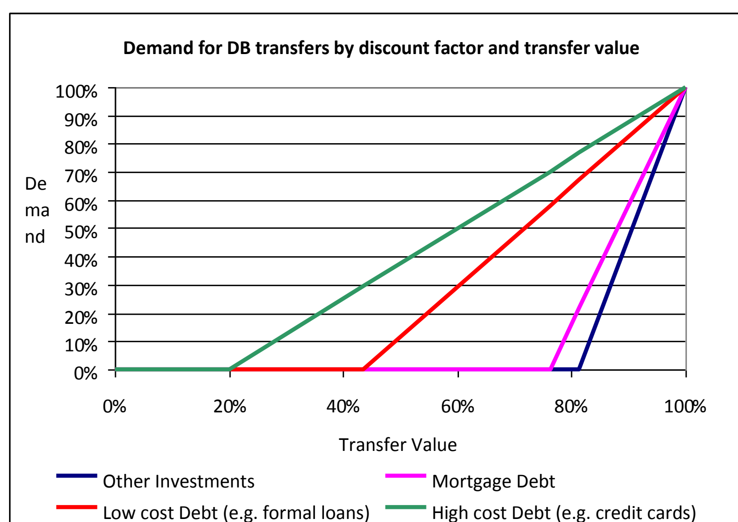
1. HMRC considered the four key segments of the population for whom this this policy will most impact (those in debt and the investors (see table 2 below)), and estimated from this the critical transfer value where, if the amount transferred into a DC pension was more than that, individuals would be willing to transfer[27]. This critical transfer value for each group is derived using their associated discount factor (based on their level of household debt) to calculate their net present value of future DB rights. A transfer value of 100% would compensate them for the forfeit of this DB pension income (although may be unable to replicate the exact benefits as if buying the same pension from an insurer – see para 14) whilst a transfer value below the critical one would make their DB pension more valuable to them.

Table 2 – Critical transfer values

	% of Pensioner Households[28]	Return (Assumed Discount Factor)	Demand for transfers if transfer value=100%	Critical transfer value
High cost Debt (e.g. credit cards)	3.5%	20.0%	100%	20.2%
Low cost Debt (e.g. formal loans)	4.6%	10.0%	100%	43.6%
Mortgage Debt	11.9%	4.4%	100%	76.2%
Other Investments (e.g. equities)	9.4%	3.8%	100%	81.4%

2. The results imply that if transfer values were around 75%, those with mortgage debt and those looking to invest would be better off remaining in their DB schemes. However, some of those with more expensive debts may be content with surrendering one quarter of the value of their pension for income today.

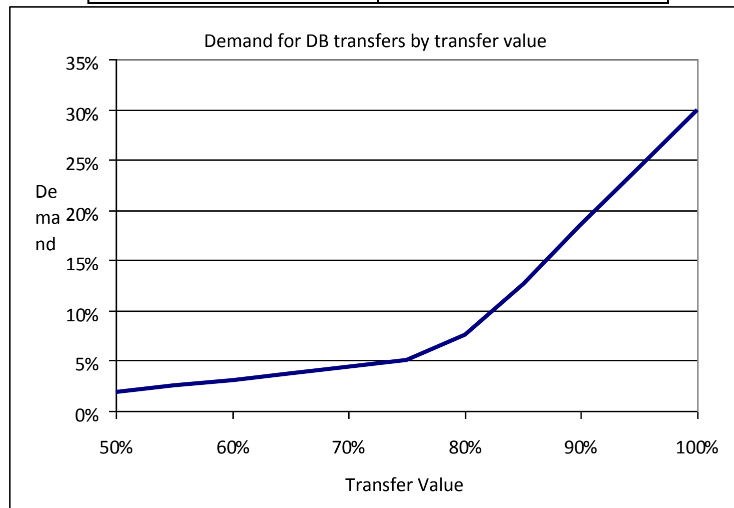
3. For each of the four categories we plot a linear relationship between the critical transfer value (where demand for transfers would be zero) and a 100% transfer value (where demand for transfers would be 100%);



[27] If acting rationally. We assume that they are making this decision aged 65, with remaining life expectancy (known to them) of 21.8 years, and that they would be surrendering a CPI-linked DB pension.

[28] Mutually exclusive, there are 6 other categories of pensioner, however the extra flexibilities should not influence their decisions to transfer and as such they are removed from this analysis.

Transfer value	Demand for transfers
100%	30.0%
95%	24.2%
90%	18.5%
85%	12.7%
80%	7.6%
75%	5.0%
70%	4.4%
65%	3.8%



4. We weight across the different discount factors using the proportions set out in table 1 to generate a weighted demand for DB transfers by transfer value[18];

5. From this, it was extrapolated that 80% would be the most likely CETV value.

6. The analysis above assumes transfer values will be 80% of the amount which would allow a transferring member to purchase a DC pension which would leave them with the same amount of income as the DB pension they're transferring out of, but not necessarily with the extra benefits associated with their DB scheme (see para 14).

7. DB transfer values are developed by incorporating high level concepts provided by an actuary into the analysis. There are a range of pension fund valuation types, with different purposes and based on different assumptions. A summary of advice from an HMRC actuary is presented below;

Alternative valuation approaches

[18] As noted in reference 28, for this analysis it is assumed that other pensioners are unaffected by the new flexibilities. If the CETV were to be extended to 100% it is possible individuals from other groups would transfer, however, this would not be based on incentivised behaviour and as such is not included in this modelling.

8. Best estimate (A) – this is the scheme's best guess of the liability. This is a present value central estimate of how much it will cost the scheme to make DB payments to the retiring individual. There will be an even chance that the actual cost to the pension scheme of paying out the member's DB pension being more/less than this.
9. Funding Reserve basis (B) – with elements of prudence added to the best estimate. With a prudential margin added, this value should be more than sufficient to meet actual cost in 'most' circumstances. How much prudence is added varies from scheme to scheme, it depends on their view of their own uncertainties.
10. Buy-out basis (C) – the cost of insuring the pensions with an insurer. This is the cost to a DB pension scheme of passing on the liabilities for all scheme members to an insurer (who takes on all responsibility for the scheme). The pension scheme would have to pay for the insurer's prudence and also profit margins, so this cost is higher again.

(C) > (B) > (A)

Transfer values offered

11. There are regulations regarding Cash Equivalent Transfer Values (CETV). These require that a transfer value should be based on the best estimate as a minimum (A), although if the scheme is in deficit it can pay less than this to avoid negatively impacting on those members remaining in the scheme.
12. In practice, schemes often pay something higher than (A), usually between (A) and (B). They may offer more than the bare minimum if they wish to reduce their exposure to longevity risk,
e.g. if the DB scheme is a problem on employer's balance sheet, it can downsize the scheme by offering higher transfer values.
13. Where transfer values lie between (A) and (B) will vary by scheme and an approximate estimate is that (A) is typically 85% of (B).

'Real world' transfer value to the member

14. If a member receives (A) or (B), or somewhere in between, they will still be unable to replicate (via an annuity) the same income that they would have received if they remained in their DB scheme. This is because an annuity provider will factor in prudence (in the form of a regulatory requirement to hold extra capital), and profit.
15. Even if the member receives transfer value (B), which takes into account some prudence (although less than a regulated insurer would), and purchases an annuity they will only receive an income of around 90% of what they would otherwise receive from their DB pension. This assumes a circa 0.5% profit margin for an annuity provider.
16. As transfer value (A) is estimated to be worth 85% of (B) on average, it follows that if the individual purchases an annuity with (A) they will only receive an income of around 75% of what they would otherwise receive from their DB pension.
17. Finally, as some schemes are in deficit and thus will offer transfer values less than A, we conclude that average transfer values are likely to be towards the lower end of the 75%-90% range, and therefore conclude at 80%.